

The Percentage Fallacy

There's one bit of irrationality that seems like it ought to be in behavioral economics introduction but mysteriously isn't. For lack of a better term, let's call it *the percentage fallacy*. The idea is simple:

One day I find I need a blender. I see a particularly nice one at the store for \$40, so I purchase it and head home. But on the way home, I see the exact same blender on sale at a different store for \$20. Now I feel ripped off, so I drive back to the first store, return the blender, drive back to the second store, and buy it for \$20.

The next day I find I need a laptop. I see a particularly nice one at the store for \$2500, so I purchase it and head home. But on the way home, I see the exact same laptop for \$2480. "Pff, well, it's only \$20," I say, and continue home with the original laptop.

I'm sure all of you have done something similar — maybe the issue wasn't having to return something, but spending more time looking for a cheaper model, or fiddling with coupons and rebates, or buying something of inferior quality. But the basic point is consistent: we'll do things to save 50% that we'd never do to save 1%.

At first this almost seems rational — of course we're going to do more to save more money! But you *aren't* saving more money. With both the blender and the laptop, you have the chance to save \$20. Either way, you're going to have another twenty in your pocket, which you can spend on exactly the same things later on. Yet we behave differently depending on whether we got that twenty by skimping on a small purchase or skimping on a big one. Rationally, if driving back to the store isn't worth \$20 when you're buying a laptop, it isn't worth \$20 when you're buying a blender.

On the other hand, don't those small savings tend to add up after a while? If you start blowing \$20 every time you buy a trinket, you're soon going to be out of disposable income. Meanwhile, spending several thousand dollars is much rarer, so isn't it OK to slack off a bit on such occasions?

If we work to save 50% on everything, big or small, that's the equivalent of saving 50% of our money altogether. Whereas if we only try to save fixed amounts on every purchase, how much we save is dependent on how many things we buy.

So which is the real irrationality? I'm not entirely sure of the answer.

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